State of California
Department of Insurance

INITIAL STATEMENT OF REASONS

AMENDMENT TO THE CLAIFORNIA CODE OF REGULATIONS TITLE 10, CHAPTER 5, SUBCHAPTER 3, ARTICLE 17

ACTUARIAL OPINION AND MEMORANDUM REGULATION

Date: August 13, 2004

INTRODUCTION

Pursuant to Insurance Code section 10489.15 we are proposing revisions to California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 17, §§ 2580.1 to 2580.9 (the "Actuarial Opinion and Memorandum Regulation"), which have been in effect since May 1, 1995. In October of 2001, the National Association of Insurance Commissioners (NAIC) adopted a revision to the Actuarial Opinion and Memorandum Regulation (Model Regulation No. 822). The Commissioner believes it is necessary to incorporate into the California Code of Regulations much of the substance of the revisions adopted by NAIC, particularly since the existing regulations, for the most part, copied the previous model regulation verbatim. Indeed, except in certain instances noted in this document, the text of the revised regulation generally copies the language of the revised Model Regulation verbatim, with only nonsubstantive changes in grammar, format and numbering.

The current NAIC revisions are in the process of being adopted by several different states. It can be beneficial to both insurers and consumers when administrative costs related to compliance with multiple, inconsistent regulatory requirements imposed by different states are reduced. The proposed regulations tend to serve this purpose by ensuring that California's regulatory requirements in this area are as consistent with those of other states as is possible under California law. To the extent that insurers, operating in compliance with California law, are able to devote additional resources — resources which would otherwise be expended satisfying multiple, inconsistent regulatory regimes — to improving their financial stability or providing better products to consumers, everyone stands to benefit. The proposed regulations are reasonably necessary to the degree to which they help to achieve progress toward this goal.

SPECIFIC PURPOSE AND REASONABLE NECESSITY

The specific purpose of each adoption and the rationale for the Commissioner's determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed are set forth below:

§ 2580.1. Purpose

We have revised the Insurance Code section reference in § 2580.1, subdivision (a) of the proposed regulations. Formerly, the regulation text cited Ins. Code § 10489.15(b); the new text cites to the entire Ins. Code § 10489.15. This change has been made in order to cause the proposed regulations to correspond more closely with the NAIC model regulation. The model regulation, both before and after the current revision, references Section 3 of the Standard Valuation Law. Section 3 of the Standard Valuation Law corresponds very closely to the entirety of Ins. Code § 10489.15, and not only with subdivision (b) thereof. For this reason, this change brings the proposed regulations into closer conformity with the model regulation, even though the change does not reflect a matching change in the current revision of the model regulation.

In accordance with a corresponding change being made in the current revision of the model regulation, Subdivision (b) of the current regulation, which indicates that one of the purposes of the article is to provide guidelines and standards for when a company is exempt, is being removed. This material is being deleted because it is being proposed, for reasons outlined in the discussion of Section 2580.2, below, that this exemption, granted to certain insurers, be removed from the proposed regulations.

Again in accordance with the current revision to the model regulation, a new subdivision (c) has been added, indicating that providing "Guidance as to the meaning of 'adequacy of reserves,'" is one of the purposes of the regulations. In light of the fact that this is, and has always been, a primary function of this article, the new language causes the statement of purpose to be more comprehensive.

§ 2580.2 Scope

In order to match corresponding language in the model regulation, the term "disability insurance" has been replaced with "accident and health insurance" among the types of insurance business being authorized to reinsure which brings a reinsurer under the scope of the regulations. This change brings the proposed regulations into closer conformity with the model regulation, even though the change does not reflect a matching change in the current revision of the model regulation.

In accordance with a corresponding revision to the model regulation, the following new language has been added under the proposed regulations: "This regulation shall be applied in a manner that allows the appointed actuary to utilize his or her professional judgment in performing the asset analysis and developing the actuarial opinion and supporting memoranda, consistent with relevant actuarial standards of practice. However, the Commissioner shall have the authority to specify specific methods of actuarial analysis and actuarial assumptions when, in the Commissioner's judgment, these specifications are necessary for an acceptable opinion to be rendered relative to the adequacy of reserves and related items." The reason for the change is to give the appointed actuary more discretion to use his or her professional judgment when doing asset adequacy testing, while maintaining the necessary level of regulatory control.

Under the current regulations there are a minimum of seven prescribed interest rate scenarios that are used as the foundation for asset adequacy analysis. Under the proposed regulations a shift to relying more on the appointed actuary to choose the scenarios is being implemented. However, if the Commissioner is not satisfied with the testing assumptions used, it is being proposed that he or she can prescribe additional scenarios to be used in the asset adequacy analysis. The seven mandatory prescribed scenarios under the current regulations may not apply to the particular circumstances of all insurers; the assets and liabilities of different insurers have different characteristics, depending on the mix of the products they are marketing, and the asset adequacy assumptions should match as closely as possible their individual circumstances. For this reason, the appointed actuary is being given more discretion in choosing assumptions more nearly akin to his or her individual circumstances, subject, of course, to the satisfaction of the Commissioner.

Furthermore, for certain smaller insurers, on whom the asset adequacy analysis requirement is now being imposed for the first time, the expense of performing the analysis as prescribed by the current regulations would be relatively more burdensome than under the proposed regulations. If the current regulations' prescribed scenarios do not apply to such small insurers, it would be a waste of their resources for them to be required to use those scenarios.

In the second paragraph of Section 2580.2, the reference to Section 2580.5 of the current regulations is being deleted since it refers to insurers being exempt from performing an asset adequacy analysis. In conformity with the recent revisions to the model regulation we are proposing that no insurers be exempt so that all insurers' reserves will be tested for adequacy. Under the current regulation, certain insurers are exempt from doing full-fledged asset adequacy testing, provided they satisfy eligibility tests listed under section 2580.5, subdivision (c). These tests are fixed formulae, which do not take into consideration the individual circumstances of an individual insurer. For example, they do not take into consideration the proportion of interest-sensitive products in the portfolio, which is an essential indicator of the need for an asset adequacy test. As a result, two companies with very different proportions of interest-sensitive products could currently receive the same exemption. Also, insurers constantly introduce new products which make these rigid tests inadequate. One possible solution is to constantly update these tests in order to keep up with the changing environment. However, since we are also proposing to eliminate other prescribed testing, e.g., the seven interest rate scenarios, and give the actuary more discretion in performing asset adequacy analysis, we propose that the exemption for any insurer be removed. This will not only bring all insurers onto a level playing field, so to speak, but will also enable the appointed actuary to utilize his or her judgment in determining the extent of the asset adequacy analysis that is necessary, taking into consideration the individual circumstances of the particular insurer.

We have inserted the word "Analysis" into the second sentence of the second text paragraph of § 2580.2 of the proposed regulations, in order to correct an inadvertent omission from the text of the regulations as originally promulgated. Again, this change causes the proposed regulations to more nearly match the model regulation, even though the change does not correspond to a change being made in the current revision of the model regulation. Additionally, the change is necessary for grammatical and stylistic reasons.

References to Sections 2580.7 and 2580.8 in the current regulations are being re-numbered to 2580.5 and 2580.6 in the proposed regulations. Since the original sections 2580.5 and 2580.6 address exempt insurers, these sections are being deleted.

Likewise, the last sentence of the second text paragraph, referring to Section 2580.6 is being deleted since it contains language about insurers being exempt from performing an asset adequacy analysis. Again, we are proposing that no insurers be exempt so that all insurers' reserves are tested for adequacy.

The third text paragraph of this section is being deleted since it makes provision for the Commissioner to request that an exempt insurer perform an asset adequacy analysis. As we are proposing that no insurers be exempt, this paragraph is no longer necessary.

§ 2580.3 Definitions

Subdivision (a), the definition of "Actuarial Opinion," is being changed slightly. One definition of the term will now apply to all companies, due to the proposed elimination of the exemption granted to certain insurers. Consequently, references to Sections 2580.7, 2580.8, and 2580.9 are being deleted. Paragraph (2), which refers to Section 2580.6, relating to Statement of Actuarial Opinion Not Including an Asset Adequacy Analysis for exempted companies, is being eliminated.

Subdivision (h) (of the current regulation), the definition of non-investment grade bonds, has been deleted from the proposed regulations, because the amount of non-investment grade bonds is used under the current regulations only to determine if a company is exempt from performing an asset adequacy analysis. As we are now proposing that no companies be exempt, this language will no longer be necessary.

§ 2580.4 General Requirements

Subdivision (a)

The latter part of paragraph (1), and paragraph (2), in the current regulation are being deleted as they refer to different actuarial opinions required from different categories of companies. Since it is being proposed, for reasons outlined in the above discussion of Section 2580.2, that the exemption granted to certain insurers be eliminated, the same type of submission would under the proposed regulations be required from all companies.

Paragraph (a)(3), referring to accepting actuarial opinions based on foreign states' laws has been deleted, in accordance with a similar revision to the model regulation. This change is consistent with the current revisions' movement toward granting the opining actuary greater responsibility, commensurate with greater discretion, than is permitted under the current regulations. Under the proposed regulations, as well as the model regulation, the responsibility for making the initial determination as to whether an opinion filed in another state does or does not sufficiently comport with California's requirements is left to the actuary rendering the opinion.

Subdivision (b)

We have inserted into the definition of the term "qualified actuary" in § 2580.4 the new paragraph (b)(3), which articulates the requirement that such person be "familiar with the valuation requirements applicable to life and health insurance companies." This addition was reasonably necessary in order to further the goal of bringing the text of the proposed regulations, wherever appropriate, into conformity with the language of the model regulation. Although this paragraph is not being added in connection with the current revision of the model regulation, the language is indeed present in the text of the model. Further, it is desirable from a regulatory standpoint to emphasize the requirement that the actuary who in the proposed regulations is being given increased latitude and responsibility—and whose judgment is being relied upon all the more heavily—actually be familiar with valuation requirements relating specifically to life and health business.

Subdivision (c)

We have stricken from subdivision (c) of § 2580.4 language from the originally promulgated regulation text that allowed insurers a period of sixty days from the effective date of the regulation in which to mail the Department information identifying the Appointed Actuary. This provision is no longer necessary in the proposed regulations, since the requirement that this information be mailed to the Department is currently in effect, and will remain in effect under the proposed regulations without change. Insurers no longer require a grace period in order to comply with this provision, as was the case when the article was originally promulgated, because they currently are, and for several years have been, required to comply. This change does not correspond to a change being made in the current revision of the model regulation.

Subdivision (e)

In conformity with the revisions to the model regulation, the phrase "whether directly issued or assumed" has been inserted into Paragraph (e)(1) in order to exclude the possible interpretation of the existing requirement that the Actuarial Opinion apply to "all" business in force to mean the opinion can apply only to directly issued business. It is necessary in order for the Actuarial Opinion to portray as completely and accurately as possible the true state of an insurer's financial affairs that the opinion apply to all, not some, of the insurer's business. Additionally, in Paragraph (e)(1) the numbers by which exhibits to the annual statement, in the form provided by the NAIC, are identified have been changed in order to match corresponding changes that have been made by NAIC to the blank annual statement form since the time the regulations were originally promulgated. The exhibits that are actually indicated by these numbers have not changed.

In order to match a corresponding change being made with the current revision of the model regulation, a list of individual Insurance Code sections detailing the method by which aggregate reserves are to be calculated has been deleted from Paragraph (e)(2). The deleted

material is being replaced by a reference to the article of the Insurance Code corresponding to the Standard Valuation Law, to which the revised model regulation refers.

§ 2580.5: Statement of Actuarial Opinion Based on an Asset Adequacy Analysis (renumbered and amended Section 2580.7 of the current regulations)

The entirety of current Sections 2580.5 (Required Opinions) and 2580.6 (Statement of Actuarial Opinion when Exempt from Section 2580.7) is being deleted. This material outlines company categories and exemptions according to which a statement of actuarial opinion is, or is not, required. As indicated above, the same statement of actuarial opinion will be required for all companies under the amended regulation.

Consequently, current Section 2580.7 entitled "Statement of Actuarial Opinion Based on an Asset Adequacy Analysis" is being renumbered as 2580.5. Modifications to the text of this section are referred below using the new section number: 2580.5.

§2580.5(a)(5)(B)

In keeping with an identical change being made in the current revision of the model regulation, subparagraph (a)(5)(B) is being deleted in the proposed regulations. The deleted language made reference to situations where methods of aggregation were required to be disclosed. Under the proposed regulations, aggregation methods no longer necessarily have to be disclosed, in keeping with the policy goal of permitting the appointed actuary increased flexibility and discretion in forming his or her opinion. (Language expressing the requirement that methods of aggregation be disclosed is being deleted, at Section 2580.9, subparagraph (a)(2)(B), of the current regulations.) However, in the event that aggregate negative ending surplus results under certain tests, the actuary must under the proposed regulations describe those tests and provide further information in the new Regulatory Asset Adequacy Issues Summary (see Section 2580.6, subparagraph (c)(1)(A) of the proposed regulations).

§2580.5(a)(5)(C)

Subparagraph (5)(C) has been deleted, in conformity with revisions to the model regulation. This material indicated a condition under which additional paragraphs would be required in the actuarial opinion, i.e., if the Company were required to disclose reliance upon certain assets. Under the proposed regulations, this condition will always be satisfied, since all companies, owing to the elimination of the exemptions from the asset adequacy analysis requirement, will be required to make this disclosure, if applicable. Consequently the material that was previously characterized as "additional" will in fact be required to be provided in all actuarial opinions. Since the paragraphs will no longer be additional but will instead be required, if applicable, in all actuarial opinions, the deleted language is no longer relevant.

§2580.5(b)(2)

Formatting and technical changes have been made to the prescribed form of the table of reserves and related items subjected to asset adequacy analysis. These changes are necessary principally in order to correct references in the current regulations to exhibits and other items in the annual statements and statements of separate accounts prepared by insurers, which references have become inaccurate owing to changes that have been made to these forms since the time the regulations were originally promulgated.

§2580.5(b)(3)

If the Appointed Actuary has relied on other experts to develop certain portions of the analysis, the current regulations require a statement from the actuary to this effect, identifying the expert, as well as the portions of the opinion where there has been such reliance. The proposed regulations, and the model regulation, not only continue to require that the expert, and the areas where the actuary has relied on the expert, be identified but also require the actuary to review "the information relied upon for reasonableness." This is an improvement over the current regulation since the appointed actuary will no longer be permitted to blindly rely on the information prepared by the expert; rather, the actuary will also be responsible for checking the material for reasonableness.

§2580.5(b)(4)

If the Appointed Actuary has examined the underlying asset and liability records himself or herself, the current regulation requires a statement to this effect, and a statement that he or she has reviewed the actuarial assumptions and has done such tests as necessary. The proposed regulations, and the model regulation, go further, by requiring the actuary to reconcile the asset and liability records against the company's annual statement. Again, this is an improvement since the actuary is required to double-check the accuracy of the records used.

§2580.5(b)(5)

If the Appointed Actuary has not examined the underlying records but has relied upon data prepared by the company, the current regulations require a statement from the actuary to this effect, identifying the name of the officer, and a statement that the actuary has reviewed the actuarial assumptions and has performed such tests as necessary. The proposed regulations, and the model regulation, require the actuary to further reconcile the data to the company's annual statement. This new requirement is an improvement since it requires an additional check of the data above and beyond what is required under the current regulations.

§2580.5(b)(6)

The first sentence of Paragraph (6) of the proposed regulations does not incorporate a change being made to the corresponding sentence in the current revision of the model regulation which would allow the opinion paragraph to include "a statement such as" the language that follows, rather than the language itself. This change is unnecessary in light of

the fact that in the first text paragraph of subdivision (b), of which subdivision paragraph (6) is part, currently provides sufficient flexibility to allow the actuary to modify the language in question, provided that the opinion retains all pertinent aspects of that language.

§2580.5(b)(6)(E)(1)

An added sentence in this paragraph grants the Commissioner discretion to allow a company's actuary to exclude the cash flow testing provision from his or her opinion. When the model regulation was being revised at the NAIC, some states insisted on the inclusion of this discretion so that they could exempt a company from cash flow testing if they thought it was necessary. It could be appropriate, under certain circumstances, to relieve from the cash flow testing requirement small companies that could not afford to perform cash flow testing, for example, or companies with insignificant high-risk business. These states felt the need for this explicit discretion particularly in the new model since the exemption granted to certain companies under the previous model was being eliminated. The exemption is limited to a company "doing business in this state and in no other state" so that no other state, except the one granting the exemption, would be affected. The added sentence is included in the proposed regulations for these same reasons. However, in the proposed regulations, we have inserted into the sentence being added with the current revision of the model regulation the word "domestic," which does not appear in the NAIC language. This modification to the language of the model regulation is necessary in order to rule out the unintended and unlikely, though not inconceivable, possibility that this discretionary exemption might be construed to be available to a company domiciled in another state yet doing business only in California.

§2580.5(e)

If the Appointed Actuary does not express an opinion and relies on others as to the accuracy and completeness of the listings and summaries of policies in force and/or asset oriented information, the current regulations require an opinion of the company officer or accounting firm who prepared such underlying data. The proposed regulations, and the model regulation, require a similar certification if the actuary relies on certification of others, but heightens the certification requirement beyond matters concerning the accuracy or completeness of data to include a statement as to the appropriateness of any other information used by the actuary and a precise identification of the items relied upon. Again, this additional requirement is an improvement since it requires a more precise certification of the information relied upon than the more general certification under the current regulations.

§2580.5(f)

Language added in the current revision of the model regulation which would correspond to Section 2580.5, subdivision (f) of the proposed regulations has not been added. Consequently no such subdivision appears in the proposed regulations. The current, as well as the proposed, regulations require the reserves of a foreign insurer to (1) meet the requirements of the Insurance Law and regulation of the state of domicile, and (2) be at least as great as the minimum aggregate amounts required by the state of California

(§2580.5(b)(6)(C)). This provision continues to be supported by California's insurance regulators since it is consistent with the Department's responsibility to be independent and impose solvency standards for companies domiciled in California without giving unfair advantage to companies domiciled elsewhere.

The new language in the revised model regulation, if adopted, would have afforded the Commissioner, in his or her discretion, the option of making one or more of three additional approaches available to the opining actuary. Each of these three additional approaches would have been based not on California law but on the law of the insurer's state of domicile with regard to the standards used for measuring the adequacy of reserves of insurers. Some states have lower standards than California's. High standards better ensure that insurers are financially sound and able to pay claims. In this way, California's current standards protect the consumer more effectively than would be the case if insurers needed only comply with the lower standards of another state. Accordingly, the new model language has not been inserted into the proposed regulations, because it would make it more likely than at present that a standard, less rigorous than California's, adopted by another state could at some point in the future apply in California.

§ 2580.6 Description of Actuarial Memorandum including an Asset Adequacy Analysis and Regulatory Asset Adequacy Summary (renumbered and amended Section 2580.8 of the current regulations)

§2580.6(a)(5)

Section 10489.15 of the Insurance Code authorizes the Commissioner to define, by regulation, the specifics of the opinion of the actuary and to "add any other items deemed to be necessary to its scope." Paragraph 2580.6(a)(5), requiring an asset adequacy issues summary of the opinion, is being added in order to follow revisions to the NAIC model and to increase the efficiency with which the actuarial opinion and memorandum can be reviewed by the Department's actuaries. The actuarial memorandum can be a voluminous and complex document, and a summary of the main issues will greatly help the reviewing regulators.

§2580.6(b)

Subdivision (b) requires a number of additional details to be provided under the proposed regulations, all in accordance with the current revision of the NAIC model. The broad purpose of these additional details is to give the Department's reviewing actuaries more insight into and a better understanding of the analysis submitted. These additional details are particularly necessary, given the other changes being made in the proposed regulations, since the appointed actuary is generally being given more flexibility in using his or her professional judgment in performing the asset adequacy analysis, as compared to the more narrowly prescribed approaches mandated under the current regulations.

New subparagraphs (b)(1)(F), (b)(1)(G) and (b)(2)(E) have been added in Section 2580.6 of the proposed regulations, in order to mirror corresponding revisions to the model regulation. The language comprising these new subparagraphs is in each case identical to the language being added to the model regulation. The purpose of this added language is to require that the

Actuarial Opinion prepared by an insurer include information necessary to enable state regulators reviewing the Opinion to evaluate more comprehensively than previously the insurer's Asset Adequacy Analysis. The inclusion of this information will provide regulators a more satisfactory basis for determining whether an insurer has adequate reserves to pay its claims.

Subparagraph (b)(1)(F) requires that certain guarantees be identified and, further, that the methods the Appointed Actuary has used in the Asset Adequacy Analysis to cover these liabilities also be identified. Subparagraph (b)(1)(G) requires that certain assumptions—assumptions which have always necessarily been made in performing the Asset Adequacy Analysis—that are used for testing the adequacy of reserves now be documented. Subparagraph (b)(2)(E) requires the documentation of certain other assumptions necessary in performing the Asset Adequacy Analysis with respect to assets. Subparagraph (b)(1)(G) and Subparagraph (b)(2)(E) each contain a sentence mandating that the required documentation be sufficient to allow an actuary reviewing the actuarial memorandum to form an opinion as to whether or not these documented assumptions are reasonable. It is necessary in order to protect policyholders for regulators to be able thus to confirm that the assumptions being used by insurers to demonstrate that their reserves and assets are adequate to cover their liabilities are indeed reasonable assumptions.

§2580.6(b)(3)(C)

Parenthetical language requiring additional information to be included with the rationale for degree of rigor in analyzing different blocks of business has been added to ensure that the Appointed Actuary not only includes the rationale but also addresses the level "materiality" that was used for analysis of a certain block of business. This change is necessary in order to ensure that the more important (e.g., larger) blocks of business are tested more thoroughly than less material blocks.

§2580.6(b)(3)(D)

Parenthetical language requiring additional information to be included with the criteria for determining asset adequacy has been added to ensure that the appointed actuary not only includes among the various scenarios being tested "moderately adverse conditions" (or other criteria specified in the relevant Actuarial Standards of Practice) but also defines the precise bases for these criteria. At present the actuary is required (under Section 2580.9(d) of the current regulations) to follow the Actuarial Standards of Practice; this requirement is being reiterated in the proposed regulations. Additionally, the listing of the details of the criteria used by the actuary becomes all the more essential in order for regulators to understand the analysis in light of the fact that, in order to give the actuary more discretion in choosing criteria most appropriate to the particular company's circumstances, the prescribed interest rate scenarios currently used to determine asset adequacy are being eliminated.

§2580.6(b)(3)(E)

The current language requires the disclosure of the effect of federal income taxes, reinsurance and other relevant factors. The proposed regulations, in accordance with revisions to the model regulation, require only a statement as to whether or not the impact of federal taxes has been

considered. Again, in keeping with the ethic of granting the appointed actuary greater discretion and responsibility, the requirement that the opinion list the specific effects of federal taxation is being eliminated. However, with regard to the treatment of reinsurance, the level of detail required has been heightened in the proposed regulations; instead of merely disclosing the effects of reinsurance, the opinion under the proposed regulations will be required to include a statement of the method by which reinsurance has been treated in the analysis. Also deleted, again in accordance with revisions to the model regulation, is language requiring that the effect of "other relevant factors" be disclosed. However, the proposed regulations, but not the current revisions to the model regulation, replace this rather vague deleted language with the new requirement that there be included in the regulatory asset adequacy issues summary "any other items that the Commissioner may request." §2580.6(c)(1)(G) of the proposed regulations.

§2580.6(b)(4)

The proposed regulations, and the current revisions to the model regulation, require that material changes from the way in which the asset adequacy analysis was performed for the preceding year be disclosed. Again, since the regulations will no longer require that specified interest rate scenarios be used to conduct the asset adequacy analysis, a comparison with the prior year's methods, procedures or assumptions becomes more important than previously. For example, if there has been a significant change in the type of interest-sensitive business written, it is important for regulators to be aware of the changes, if any, which the appointed actuary is making in the asset adequacy criteria used.

§2580.6(c)

As mentioned above, the requirement for an Asset Adequacy Issues Summary is being added in order to follow revisions to the NAIC model and to increase the efficiency with which the actuarial opinion and memorandum can be reviewed by the Department's actuaries. The actuarial memorandum is a complex, often voluminous document, and a summary of the main issues, as outlined in this section, will aid the reviewing regulators.

§2580.6(c)(1)(G)

The added Section 2580.6(c) follows, almost verbatim, the revised NAIC model, except for the addition of subparagraph (G), which requires the inclusion of "Any other items that the Commissioner may request." This language has been added in the proposed regulations to cover any additional unforeseen items which may become necessary due to unexpected or extraordinary circumstances. The language replaces language being deleted from the model regulation, and from the current regulations, which required that the Actuarial Opinion and Memorandum include a statement of the effect of "other relevant factors." Cal. Code Regs., tit. 10, section 2580.8(b)(3)(E).

New products emerge almost continuously, and new insights are constantly gained regarding key aspects which ought to be documented in the memorandum and its issues summary. Often there is no way these changes in conditions can be predicted or anticipated in advance.

Examples of such unexpected circumstances are the recent changes in economic environment which resulted in historically low interest rates. Many life insurance and annuity policies have contractual minimum guarantees of a fixed interest rate, or guarantees linked to a fixed interest rate, e.g. fixed interest guarantees under Universal Life policies. With the lowering of interest rates, these guarantees became more meaningful. There was an immediate need for regulators to examine these guarantees more closely, and obtain additional information on reserves as soon as possible, to ascertain their adequacy to meet claims.

New products emerge in the marketplace from time to time, with innovative features which cannot not be foreseen or anticipated. Additional information is required about these products to ascertain adequacy of reserves to meet claims. Examples of these products in the past have been:

- Variable Annuities with guaranteed living benefits (e.g. guaranteed minimum accumulation benefits, guaranteed minimum income benefits, and guaranteed payout annuity floors), and Variable Annuities with guaranteed minimum death benefits: Variable annuities are policies that provide for annuity benefits that vary according to the investment performance of a separate account, so that the investment risks are passed on to the policyholders by insurance companies. However, over time, insurance companies included certain minimum guarantees as outlined above, so that the companies started bearing certain additional risks. These additional risks needed to be reserved for adequately, and regulators needed to ascertain that this was being done, sooner rather than later.

- Separate Account Guaranteed Interest Contracts (GICs) with general account guarantees: These are investment-type policies issued out of separate accounts to institutional clients but with returns guaranteed by the company. As was the case with variable annuities, these products caused companies' general accounts to take on additional risk, due to the guarantees. When these products were first introduced, again, there was an urgent need for regulators to obtain additional information to ensure that the separate account was compensating the general account adequately for the risk, and that the general account was reserving adequately for the guarantees provided to institutional clients.

In each of the above cases regulators required the information from the insurers within a short span of time, if not immediately, to ensure that adequate measures would be in place as soon as possible. However, quite often, when adequate measures were in place to the satisfaction of the regulators, there was no longer a need to require the same information in subsequent years.

§2580.9 (of the current regulations)

Most of the text of current Section 2580.9 is being deleted in the proposed regulations, in accordance with a matching change in the current revision of the model regulation. The deletion of much of this material is necessary in light of the proposed regulations' granting to the appointed actuary greater discretion in choosing the assumptions most appropriate to his or her individual company's particular circumstances. The mandatory methods specified in the deleted language may or may not apply to the particular circumstances of an insurer. The assets and liabilities of different insurers have different characteristics depending on the mix of products on their books, and the asset adequacy assumptions should relate as closely

as possible to their individual circumstances, if the Actuarial Opinion and Memorandum is to portray as accurately as practicable the true state of the insurer's financial soundness.

ECONOMIC IMPACT ON SMALL BUSINESS

The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business. Indeed, the proposed regulations are not anticipated to affect small business. Although performance standards were considered as an alternative, they were rejected, in part, because the kind of risks from which the regulations seek to protect consumers cannot practicably be gauged by means of a performance standard.

IDENTIFICATION OF STUDIES

There are no specific studies relied upon in the adoption of the proposed regulations.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of these regulations would not mandate the use of specific technologies or equipment.

ALTERNATIVES

The Commissioner has determined that no reasonable alternative exists to carry out the purpose for which the regulations are proposed.

PRENOTICE WORKSHOP FOR DISCUSSIONS

The Commissioner conducted prenotice public discussions pursuant to Government Code section 11346.45 on May 1, 2002. Input obtained during the workshop was considered in formulating the proposed revisions.